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10 May 2000

Mr A Reeves
Commissioner
Government Prices Oversight Commission
GPO Box 770
HOBART TAS 7001

Dear Commissioner

RE: RESPONSE TO THE DRAFT GPOC REPORT

1 Introduction

Metro welcomes the release of the draft report "Investigation of Metro Pricing Policies" by GPOC. The draft report provides the basis for a more detailed consideration of a wide range of important factors relating to the future regulatory and contractual framework within which Metro will operate.

This submission supplements material provided in the original Metro submission and addresses the following issues:

- The main objectives of the GPOC report;
- The general policy issues addressed by GPOC;
- The derivation of estimates of "efficient costs" in providing Metro services';
- The return on capital;
- "Recommended" fare levels; and
- Indexation of costs..

2 Primary Objectives of the GPOC Report

The two primary objectives of the GPOC report are considered to be:

- The development of detailed estimates of the efficient costs of providing Metro's urban public transport services; and
- The development of firm recommendations for Government on the appropriate levels of increases to Metro's current fare structure.

It is noted that the Commission considers that it is inappropriate to make specific recommendations on fares, and cites the absence of a clear Government policy framework regarding the provision of urban public transport as a key reason for not developing firm recommendations.

In the absence of such clarity a way forward for the Commission in this regard could be to accept the existing Metro fare structure and range of ticket types as reflecting the evolution of Government policy in this area and to develop the range of opinions it has expressed on fares into conditional recommendations.

3 General Policy Framework

The provision of urban public transport in Tasmania is at an important policy crossroads. GPOC has highlighted this by referring to the changes that are taking place to transport legislation, and the process adopted for introducing a new “Metro style” public transport service into Devonport. GPOC also identified the importance of achieving greater clarity as to the Government’s objectives and policies in relation to the provision of urban public transport and the setting of fares. Metro understands that these matters are to be considered by the Department of Infrastructure, Energy and Resources, in consultation with key stakeholders.

The two fundamental questions that GPOC has asked in relation to public transport policy are:

- What type of urban public transport services does Government want to buy to meet the community’s needs?
- How does Government want to contract in the provision of these services?

3.1 What Type of Urban Public Transport System Does Government Want Provided?

The Commission states that:

The patronage trends indicate a need for a radical reassessment of public transport services. There is however no clear objective for urban public transport and the first step in any such re-assessment is to identify community transport needs and consider whether Metro style services are the most appropriate for the future.

In Metro’s view this is an extremely important observation, and may in fact be the single most important point raised in the entire draft report.

Metro is concerned about the historical trends in patronage and the need to properly address this matter. In 1999 Metro engaged consultants to examine the factors underlying patronage decline, a study that was supported by the Department of Infrastructure, Energy and Resources.

In addition, Metro also engaged consultants to undertake an independent cost and productivity benchmark study to compare Metro's costs by comparison to a range of mainland private and public sector operators. The Commission has relied heavily on data emanating from both these studies.

The Benchmark Assessment report indicates that by comparison to public sector operators Metro is performing very well. However, comparison with the private sector operators indicates that there is potential for further efficiencies. It should be noted that the private sector have far greater flexibility in how they deploy their labour resources as well as lower unit costs; the private sector also do not undertake a range of functions performed by public sector operators.

Whilst the benchmarking costs study is commercial-in-confidence the patronage study has been undertaken with a view to it being used to assist the Department of Infrastructure, Energy and Resources in addressing the important public transport policy issues. However, these are not simple matters to resolve and it may take some time before the necessary work is completed and all stakeholders properly consulted. Resolution of these matters is the domain of the Government through the Minister and the Department.

Related to this issue the draft GPOC report made reference to the potential role that local government may play in contributing to the provision of urban public transport. Clearly if the needs of the community for public transport are greater than the role that State Government determines is appropriate for it to provide, then there will be a need to consider how this gap is to be filled. If local government played a more direct role in this regard it may be that there would be greater integration of policies relating to parking and support for public transport.

3.2 The Process For Purchasing Urban Public Transport Services

GPOC has made the assumption that once the public transport services that are required have been specified, then the most efficient way for these to be delivered is by competitively tendering for these services. GPOC also states that the basic tendering model would be one which involved:

- *the current integrated timetable of scheduled route services and dedicated school services;*
- *the use of existing Metro depots and other facilities; and*
- *the use of the existing Metro fleet.*

The question of how services are to be purchased is a matter for Government to determine having considered all the social and economic issues. Open competitive tendering is one option, contestable benchmarking is another option and there are several options in between.

GPOC has chosen to use open competitive tendering as the benchmark model.

GPOC has identified that in order for Metro as a company to compete fairly in such an open competitive tendering process there need to have been a number of fundamental changes made to award rates and employment conditions. GPOC has concluded that

Metro would be unlikely to be successful in an open tendering of services without substantial changes in employment conditions.

Metro's understanding of Government policy in this regard is that Metro will remain in public ownership and will not be privatised.

The main reason for GPOC raising the issue of competitive tendering for urban public transport is to form the basis of a model for determining and demonstrating what the "efficient costs" can potentially be for the provision of urban public transport services.

Metro's view is that if this model is not Government policy then it is inappropriate to use it as the benchmark against which Metro is to be assessed. Rather it would be more reasonable to establish what the "efficient costs" would be, working within the current environment of a publicly owned urban public transport service provider, with associated working conditions and constraints.

Metro does not consider it appropriate to comment on the merits or otherwise of government policies in the areas of Metro ownership and competition for contract services, private or Metro operated. These matters are rightly the province of the Government on behalf of the community.

However, it is clear that if such benchmarks are to be adopted then it needs to be recognised that this will require the existing Metro Award structure to be replaced by the award structure applicable to the Transport Workers Union (private sector award) or the adoption of separate enterprise agreements with employee conditions based on this award. Clearly any changes made in this area would require the close involvement of unions and the adoption of suitable compensation packages to "buy out" current award conditions.

GPOC have recognised the difficulties inherent in achieving these efficient benchmarks by indicating that

..... such benchmarks would not be achievable without significant compensation to staff, and may not be achievable in the current environment.

There may be a need for the Commission to obtain explicit guidance from the Department as to the Government's policy in this regard.

If it is accepted that in the foreseeable future, the current operating environment (post legislative reform) will prevail, then the benchmarks proposed cannot be delivered. That is not to say improvements in costs and productivity cannot be achieved, initiatives and cost measures are embedded in Metro's Corporate Plan. The task of developing best practice cost benchmarks in Tasmanian Government operating environment and enshrining them in a service contract for Metro is a more relevant approach in Metro's judgment. There needs to be some attention to the setting of more appropriate cost benchmarks that more directly relate to operational environment that more realistically is likely to exist for the immediate future.

4 The Derivation Of Estimates Of Efficient Costs

4.1 Appropriateness of Benchmark Costs

The approach adopted by GPOC is to consider Metro's costs on a category-by-category basis and judge if these costs could be reduced if an efficient private sector operator were providing the services, such as might occur through application of an open competitive tendering process.

Three areas of costs are identified as being able to be reduced through this approach:

- Drivers;
- Administration and general labour; and
- Repairs and maintenance.

4.1.1 Drivers

The assumption is that a 15% efficiency factor could be applied to drivers. Whilst it is accepted that such a saving may eventuate if open competitive tendering were adopted, the likelihood of this outcome eventuating in the foreseeable future is considered remote. Metro costs in this area are significantly lower than its public sector counterparts in other States. In the absence of competitive tendering it would be necessary to identify a more realistic benchmark that may be achievable over a defined period of time.

As stated previously it is important to recognise that the adoption of the benchmark rates in this area will necessarily require the negotiation of suitable transitional and compensation arrangements with relevant parties. The scale of the task involved in this should not be underestimated.

4.1.2 Administration and General Labour

The Commission has assumed that the same 15% efficiency factor that has been adopted for drivers is also applicable for administration and general labour.

The GPOC report identifies a range of constraints that limit the ability of Metro to match its driver's working hours to the pattern of customer demands it faces. These same constraints do not apply for general and administrative labour.

The benchmark assessment shows that the private sector operators do not perform (or perform to a much reduced extent) a range of functions and responsibilities such as operational planning, passenger security services, public information dissemination and infrastructure provision and maintenance. These additional overhead responsibilities are common amongst public sector operators.

As a general guide Metro's costs in this area should be about 90-95% of the mainland public sector operators due to Tasmania's lower wages & salaries (refer GPOC's footnote on page 31). Public sector costs should be generally higher than private sector costs in this area due to increased roles and functions. This is a better explanation of the 144% comparative figure identified by GPOC.

It is argued that the efficiencies proposed by GPOC can only really be gained by dropping "public sector" functions.

As such it is argued that no case has been substantiated for a 15% efficiency factor in this area. If there is no efficiency factor for this component; this would have the effect of increasing the "efficient costs" by about \$450,000.

4.1.3 Repairs and Maintenance.

In relation to repairs and maintenance there is an assumption of a 25% saving being achievable. Whilst savings may be achieved by doing things smarter it is argued that there are potential risks to public safety or the reliability of public transport services if savings are achieved by not doing or significantly deferring maintenance work.

It is argued that a benchmark efficiency saving of this magnitude needs more substantiation, given the potential impact upon safety and/or reliability.

It should be noted that since 1998/99 (the date for the BAH benchmark assessments) there has been some further progress by Metro in developing improved practices in this area. This progress will need to be defined when considering the final benchmark targets for this area. There is also a need to be clear about the assumptions upon which the attainment of such a benchmark could be based.

4.2 Distribution of Metro Costs

The analysis undertaken by GPOC on the breakdown of Metro's costs was based on the draft Booz Allen Hamilton report. A revised set of spreadsheets has now been provided to Metro. This changes the allocation of costs in a number of areas. An amended set of spreadsheets will be forwarded to you separately. This will result in minor modifications being required to Tables 4.1 and 4.3 as shown below.

The changes relate to:

- Part of the costs allocated to driving were involved with drivers undertaking other duties, such as bus cleaning. These costs have been reallocated to the other functions. This has had the effect of slightly reducing the percentage costs attributed to driving and slightly increasing the costs allocated to cleaning.
- The BAH data base inadvertently excluded vehicle insurance, registration and third party insurance. These cost items amount to \$533,000 and are allocated to Repairs and Maintenance and General Overheads. The percentages for these cost items thus need to be increased marginally.

The revisions required to Table 4.1 are as follows:

Revisions to Table 4.1 Composition of Metro Costs:		
	Old % figures	Revised % figures
Drivers	43.1	41.64
Administration & general labour	9.0	8.81
Bus running	11.3	11.12
Bus repairs & maintenance	9.2	9.37
Bus cleaning	1.3	1.81
Infrastructure repairs & maintenance	1.3	1.34
Non-labour overheads	7.4	8.80
Sub Total operating costs	82.6	82.90
Capital Buses	14.7	14.40
Capital Land & buildings	1.0	0.97
Capital traffic facilities	0.5	0.53
Capital Other	1.2	1.20
Sub Total Capital	17.4	17.10

Corresponding modifications also need to be made to Table 4.3 as shown in the following table:

Cost Component	% Distribution of Costs		Benchmark % figures	
	Old figures	Revised % figures	Old figures	Revised % figures
Drivers	52.2	50.23	44	42.70
Administration & general labour	10.9	10.63	9	9.04
Bus running	13.7	13.41	14	13.41
Bus repairs & maintenance	11.1	11.30	8	8.48
Bus cleaning	1.6	2.18	2	2.18
Infrastructure repairs & maintenance	1.6	1.62	2	1.62
Non-labour overheads	9.0	10.62	9	10.62
Total	100	100	88	88.04

As shown above these modifications have no net effect on the 88% benchmark factor used in calculating the efficient costs once figures are rounded.

4.3 Efficient Aggregate Costs.

The basic approach adopted in the draft GPOC report is to first establish what would be an efficient cost for the provision of the urban public transport services delivered by Metro under its current CSO contract (excluding charter). Advice is then provided as to what would be an appropriate set of passenger fares for such services. This can be used to define the passenger contribution to the cost of these urban public transport services. The difference between these two amounts will become the net cost to Government of delivering the established urban public transport services (GPOC report page 37).

GPOC has identified efficient operating costs in the order of \$21.4M. To this were added the capital items of depreciation (\$2.9M) and return on capital (\$2.1M). This provides an estimate of efficient aggregate costs of \$26.4M for 1999/2000.

Adoption of the GPOC "recommended" fare levels (see section 5 below) would result in lower net revenues to Metro than an across the board increase in line with GST and past inflation. As a guide the net impact would be to reduce the net revenue to Metro from about \$6.4M to about \$6.14M. This will flow back into the net Government funding.

In light of the discussions above on benchmark costs it is considered that a case has been substantiated to:

- Adopt a more realistic target benchmark for drivers;
- Eliminate the 15% efficiency target for administrative and general labour
- Review the efficiency factor proposed for repairs and maintenance.

The bottom line is that the efficient cost benchmarks cannot be adopted if the assumptions underlying the benchmarks are not realistic. Changes in the benchmarks will naturally result in the recommended “efficient operating cost” figure of \$21.4M being increased. This will flow through to the net funding from Government.

As outlined in its earlier submission Metro supports the introduction of the concept of a return on capital. It is recognised that due to the special ownership arrangements of Metro any increased funding in this regard would be likely to flow back to the shareholders in dividend payments as a return on their equity. If the efficient cost benchmarks are not adopted this return may be lower than the Commission’s estimated return on capital.

4.4 Indexation.

The Commission has identified that it will further investigate the issue of a suitable indexation for application to Metro. Metro’s position is that any indexation arrangements developed should reflect increases in its costs and should be applied to both revenues it receives from fares as well as the Government contract payment.

It is recognised that in this process there needs to be consideration given to how to provide incentive to continually better manage costs. However, many of Metro’s cost factors (such as fuel price and award determinations) are beyond Metro’s control.

Metro is prepared to provide whatever assistance it can to the Commission in its detailed work concerning the development of suitable indexation arrangements.

4.5 The Effect Of GST of Costs and Revenues

A recent report received from Deloitte Touche Tohmatsu has estimated the net impact of the New Tax System as 4.3 % not 4.7%. The lower figure is appropriate if there is no “return on capital”, whereas the higher figure is appropriate if return on capital.

More detailed data on the impacts of the New Tax System on Metro’s operating costs can be provided to the Commission as required.

The net fares revenue figure in Table 3.2 for 2000/2001 is based on a 4.3% GST impact including an allowance for the elasticity impact upon patronage of such a fare increase. No provision has been made for an additional fare increase to reflect general cost increases since July 1996.

5 Fares

GPOC indicates that it will not be making specific “recommendations” with regard to Metro fares. Instead it outlines its views on fares, which can be summarised as follows:

- There should be no increase in adult concession fares;
- There is no case for an increase in Metro student fares given the significantly lower fares charged students using private sector services;
- There is a case for a general increase in adult fares to cover the increases in the CPI over the last 3 years plus the net effect of GST;
- Adult fares should increase more directly with the distance travelled;
- There may be a case for the afternoon time restriction on the use of day-trippers and day-rovers to be lifted (reflecting Metro’s earlier proposal).

The lack of specific recommendations on fares could make deliberation on Metro fares a difficult task for Government. It may be appropriate for the Commission to become involved in the process whereby the Departments of Infrastructure, Energy & Resources and Treasury & Finance develop specific fare recommendations for Government in order that the full benefit of the Commission’s knowledge in this regard is properly harnessed.

In this process it will be essential to give consideration of the broader social implications of any recommendations on fares given the socio-economic profile of Metro users. This has previously been addressed on page 34 of Metro’s initial submission.

5.1 The Budgetary Impacts Of The Fare Recommendations.

In its report GPOC identifies Metro’s estimate of net fares revenue (after payment of GST) as \$6.407M for 2000/2001 (Table 3.2). About two thirds of Metro’s fares revenue is derived from students (29.8%) and adult concession travellers (36.6%). It is estimated that if fares for these categories of passengers are retained at current levels then passenger fare revenues will fall by \$210,000. This will result in \$19,090 less GST being paid to the Commonwealth and \$190,910 less fares revenue being retained by Metro.

The flow-on impact will be that the State Government will need to increase its net funding of Metro by \$210,000 in order to purchase the same levels of service. One eleventh of this amount will go to the Commonwealth as GST (\$19,090) whilst the balance will be retained by Metro. The State Government will be able to claim an input credit for the GST amount, which would not be possible if Metro had received the revenue via the farebox. The net result would be that the Commonwealth would effectively forego \$19,090.

It is important that the financial impacts of such a proposal are clarified in order to enable a decision to be made in light of the implications for government finances.

There is also a potential budget impact if there is a change in the time restriction on the use of day-tripper and the day-rover off-peak multi-ride tickets, enabling them to be used at any time in the afternoon (as originally proposed by Metro). An estimate of the revenue impact of this in the case of Hobart is a \$55,000 reduction in gross passenger fare revenues (Appendix D of Metro's initial submission) unless there is an offsetting increase in fares (Metro's initial submission indicated that a 10c increase in day tripper and day rover fares would offset any revenue loss). The extension of this change to the whole of Metro's operations will increase the budget estimate. Against this it can be noted that GPOC have suggested that day-rover fares may increase by 10c. If these two factors offset one another the total budget impact of GPOC's proposed fare "recommendations" could be increased to about \$265,000 if there were no increases to day-tripper fares to offset more flexible hours of operation.

5.2 Adult Concession Fares

The analysis leading to the conclusion that general concession fares should be retained at current levels was based on a comparison of standard concession fares.

The analysis does not specifically take into account the use of the off-peak day-tripper fare. This is the most popular form of adult concession fare, accounting for 46.4% of adult concession traveller fares revenue, and more than 50% of boardings.

The average number of boardings for passengers using off-peak day tripper tickets is 2.7. This indicates that a significant proportion of such passengers undertake 3 or 4 short trips and as such pay less than the \$1.20 fare for each of those trips. This will tend to make Metro's concession fares compare more favourably with other centres and redress the apparent "unfairness" of charging a flat concession fare irrespective of distance travelled.

Other states also have day-tripper type concession fares, although it is not always possible to draw a direct comparison with the off-peak day-tripper fare provided by Metro. A provisional search of website data provides the following table summarising these fares (this will be verified in due course). It is not known if such ticket types are widely used, particularly in cities that have low concession fares for short distance trips (this is also to be checked).

City	Concession “day tripper” type ticket		Comment
	Off-peak	Any Time	
Sydney	\$4.25	\$6	Bus and Ferry use
Adelaide	\$2.70		
Perth	\$2.80		Not able to be used 7:15 to 9:00
Brisbane		\$4	Any mode within 25 kms of GPO
Melbourne		\$2.30; \$3.60	Zone1; Zones 1 & 2
Canberra	\$1.00	\$3.50	
Hobart	\$1.90		

The conclusion that can be drawn from this is that there may well be a case for an increase in the prices of off-peak day-tripper tickets and 10 day day-tripper tickets, particularly if the restrictions on afternoon hours of use are lifted.

There also seems to be a need to look more closely at the appropriate fare structure for concession travellers as a flow on from clarification of Government public transport policy objectives.

In the near future Metro is proposing to progressively replace its ticketing system. This may well provide the flexibility to totally review the range of ticket types available so as to more accurately reflect Government policy objectives regarding accessibility to urban public transport services.

5.3 Fares Adjustment Process

A number of practical difficulties have been identified with the historical Order on Metro fares that should be resolved in any new Order.

These problems are as follows:

- Rounding and average fares – the current Order requires that no individual fare increase can be greater than the specified indexation. Any new Order should permit rounding within reasonable limits provided that on average fare increases are controlled.
- Loss of indexation – the current Order makes adjustments on the basis of published indices and then restarts the indexation clock for future increases on the date that fares are adjusted. This means that there is potentially a period of 3-6 months inflation that is lost every time fares are adjusted. This is not a significant issue in times of low inflation but could become significant if there were major cost increases during such a period of time.

It could be desirable for GPOC to document these practical difficulties in its final report together with a recommendation that they be resolved in any new Order.

Yours sincerely

Laurie Hansen
CHIEF EXECUTIVE OFFICER